OUTSMARTING VOLATILITY DURING RETIREMENT

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The retirement "playbook" is being rewritten.

Historically low bond yields have complicated the quest for reliable income in retirement. Not only do we want to engineer the equivalent of a steady paycheck, we also need it to keep pace with inflation.

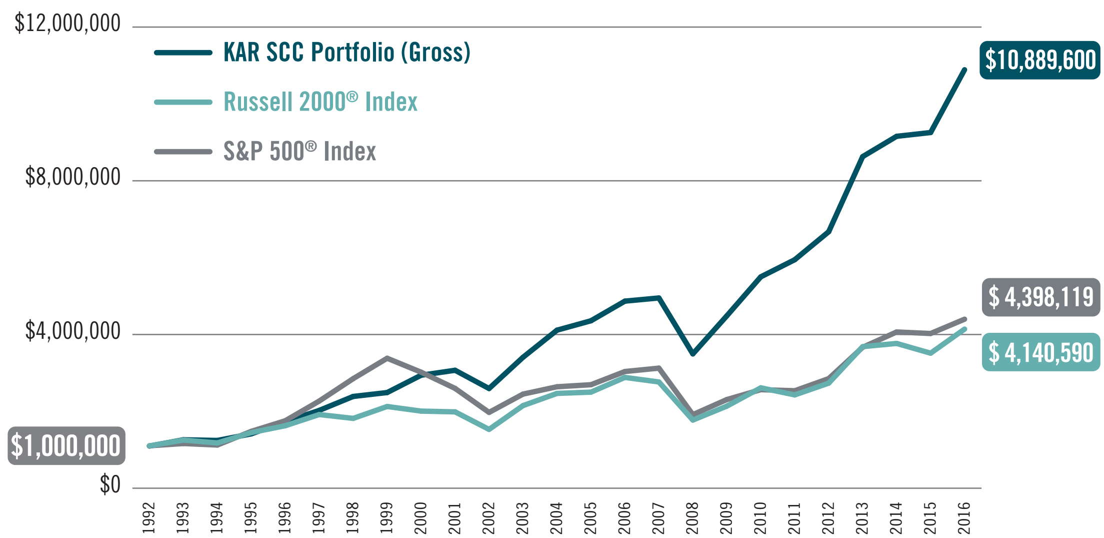
A different path with lower volatility equities

One potential solution for creating a reliable income stream in retirement is the *systematic withdrawal* from an equity portfolio. But it has a catch: market volatility can severely disrupt smart planning. Big losses can get income off track—and keep it off track. Thus, in order to employ this technique effectively, it's important to choose investments with the potential for steadier compounding.

Take a real world example of a $1,000,000 nest egg from which we're going to withdraw 5% per year: $50,000 to start, adjusting upward each year to neutralize a 3% inflation rate. We'll compare what happens to our nest egg across three different vehicles, two indexed and one actively managed: the Russell 2000® Index, S&P 500® Index, and the Kayne Anderson Rudnick (KAR) Small Cap Core separately managed account.

The following graphic shows the results going back to March 1992, the inception date of the KAR Small Cap Core portfolio.

A STEADIER SEQUENCE OF RETURNS MARCH 1992–DECEMBER 2016



RETURNS (%)[2]	1992[3]	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
SCC (Gross)	9.65	20.00	2.75	18.57	26.98	21.00	20.98	7.02	20.98	6.82	-13.73	35.02	23.07	7.87	13.46	3.25	-28.15	31.80	24.83	9.64	13.75	30.89	7.31	2.09	18.88
SCC (Net)	7.25	16.54	-0.26	15.07	23.22	17.45	17.42	3.93	17.42	3.74	-16.34	31.19	19.42	4.63	11.87	1.71	-29.36	29.72	22.52	7.75	11.80	28.76	5.57	0.51	15.41
Russell 2000	10.16	18.88	-1.82	28.45	16.49	22.36	-2.55	21.26	-3.02	2.49	-20.48	47.25	18.33	4.55	18.37	-1.57	-33.79	27.17	26.85	-4.18	16.35	38.82	4.89	-4.41	21.31
S&P 500	10.41	10.08	1.32	37.58	22.96	33.36	28.58	21.04	-9.10	-11.89	-22.10	28.68	10.88	4.91	15.79	5.49	-37.00	26.46	15.06	2.11	16.00	32.39	13.69	1.38	11.96

Certainly what jumps out is the fact that even after withdrawing an inflation-adjusted 5% per year—a total of **$1,721,323**—the KAR portfolio ended up at $10.9 million, well more than double what the passive vehicles returned.

[1]Source: Morningstar Direct. Withdrawals taken in December of each calendar year.
[2]Sources: SCC (Gross and Net)–Kayne Anderson Rudnick. Returns for the Kayne Anderson Rudnick composite are preliminary. For further details on the composite, please see the disclosure statement in this presentation. Indexes–Morningstar Direct. Negative performance years are highlighted in red.
[3]Returns shown for 1992 represent nine months of performance only. The **Russell 2000® Index** is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The **S&P 500® Index** a free-float market capitalization-weighted index of 500 of the largest U.S. companies. The indexes are calculated on a total return basis with dividends reinvested. The indexes are unmanaged, their returns do not reflect any fees, expenses, or sales charges, and they are not available for direct investment. **Past performance is not indicative of future results.**

Kayne Anderson Rudnick

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continued

Key Takeaways:

- With global bond yields at rock-bottom levels, we need to employ our equity portfolios more than ever to help fund retirement income.
- Because equities are volatile, however, we have to be vigilant in choosing defensive or risk-mitigating strategies. In the case of KAR, an emphasis on profitable, high-quality companies has put them in good stead during tough times.
- Even comparing two equity strategies with *similar* returns, the one with better downside protection during falling markets is better positioned to help safely generate income in retirement.

There's more here than meets the eye, however. The KAR portfolio was much better at avoiding losses during this stretch. In fact, the Russell 2000® Index experienced eight annual losses, while KAR only had two. The consequence of that is harder to see in a long bull market with big gains in the early years. It's easier to see in cases when we get "unlucky" and face tough markets at the start of our decumulation phase.

The data in the following table takes the real world "unlucky" case of starting retirement at the onset of a prolonged bear market. Any investment which offers a more consistent return pattern, including smaller drawdowns, is better able to sustain a healthy retirement. In the long run, it matters a lot: even with a sharp market rebound in 2003 after our unlucky start, the S&P 500® barely recovers and runs out of money. The Russell 2000® Index produced okay results after a tough start. Due to playing defense well in the early choppy markets, the KAR portfolio generated the needed income and left a much larger nest egg to boot.

STARTING RETIREMENT BEHIND THE 8-BALL

	5% Initial Draw + 3% Inflation ($)	KAR Small Cap Core (Gross) ($)	Return (%)	Russell 2000® Index ($)	Return (%)	S&P 500® Index ($)	Return (%)
2000	50,000	1,159,708	20.97	919,790	-3.02	858,956	-9.10
2001	51,500	1,187,295	6.82	891,157	2.49	705,362	-11.89
2002	53,045	971,185	-13.73	655,571	-20.48	496,428	-22.10
2003	54,636	1,256,631	35.02	910,717	47.25	584,190	28.68
2004	56,275	1,490,297	23.07	1,021,370	18.33	591,487	10.88
2005	57,964	1,549,564	7.87	1,009,918	4.55	562,577	4.91
2006	59,703	1,698,409	13.46	1,135,709	18.37	591,729	15.79
2007	61,494	1,692,097	3.25	1,056,431	-1.57	562,745	5.49
2008	63,339	1,152,368	-28.15	636,155	-33.79	291,203	-37.00
2009	65,239	1,453,676	31.81	743,771	27.17	303,030	26.46
2010	67,196	1,747,031	24.80	876,314	26.85	281,480	15.06
2011	69,212	1,846,140	9.63	770,510	-4.18	218,213	2.11
2012	71,288	2,028,707	13.75	825,199	16.35	181,846	16.00
2013	73,427	2,581,909	30.89	1,072,134	38.82	167,316	32.39
2014	75,629	2,694,768	7.30	1,048,979	4.89	114,590	13.69
2015	77,898	2,673,409	2.10	924,778	-4.41	38,277	1.38
2016*	80,235	**3,098,007**	18.88	**1,041,594**	21.31	**0**	11.96
Total Withdrawn	**1,088,079**						
Average Annual Return			10.77		6.27		0.53

Source: Morningstar Direct. Withdrawals taken in December of each calendar year.

▶ **To learn more** about Kayne Anderson Rudnick's relentless focus on high-quality businesses, contact us at **1-800-243-4361** or visit **virtus.com.**

*Withdrawal amount from SCC (Gross) and Russell 2000® Index is $80,235. Withdrawal from S&P 500® Index is the remaining balance.
Returns for the Kayne Anderson Rudnick composite are preliminary and gross of fees. For further details on the composite, please see the disclosure statement in this presentation. **Past performance is no guarantee of future results.**

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DISCLOSURE

Kayne Anderson Rudnick Investment Management, LLC claims compliance with the Global Investment Performance Standards (GIPS®) and has prepared and presented this report in compliance with the GIPS® standards. Kayne Anderson Rudnick Investment Management, LLC has been independently verified for the period from January 1, 1999 through December 31, 2014.

Verification assesses whether (1) the firm has complied with all the composite construction requirements of the GIPS® standards on a firm-wide basis and (2) the firm's policies and procedures are designed to calculate and present performance in compliance with the GIPS® standards. The Small Cap Core Wrap Composite has been examined for the period from January 1, 1999 through December 31, 2014. The verification and performance examination reports are available upon request.

Kayne Anderson Rudnick Investment Management, LLC, a wholly owned subsidiary of Virtus Investment Partners, Inc., is a registered investment advisor under the Investment Advisers Act of 1940. Registration of an Investment Advisor does not imply any level of skill or training. Kayne Anderson Rudnick Investment Management, LLC manages a variety of equity and fixed-income strategies focusing exclusively on securities the firm defines as high quality.

The composite includes all fully discretionary Small Cap Core Wrap Portfolios. Small Cap Core Wrap Portfolios are invested in equity securities with market capitalizations consistent with the Russell 2000® Index, that have market control, rising free cash flow, shareholder-oriented management, strong consistent profit growth, and low-debt balance sheets. For comparison purposes, the composite is measured against the Russell 2000® Index. The Russell 2000® Index is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. The index is calculated on a total-return basis with dividends reinvested. Benchmark returns are not covered by the report of the independent verifiers. The composite was created in October 1995. A list of composite descriptions and policies for valuing portfolios, calculating performance, and preparing compliant presentations are available upon request.

Beginning on January 1, 2006, sub-advisory wrap fee portfolios are also included in composite results. Each sub-advisory relationship is included in the composite as one account. Prior to January 1, 2011, accounts that experienced a significant cash flow, defined as aggregate flows that exceed 25% of the account's beginning of period market value, were temporarily removed from the composite. Prior to January 1, 2011, the composite minimum was $100,000.

The standard wrap fee schedule in effect is 3.00% on total assets. Actual management fees charged may vary depending on applicable fee schedules and portfolio size, among other things. Additional information may be found in Part IIA of Form ADV, which is available on request. The performance information is supplied for reference. Past performance is no guarantee of future results. Results will vary among accounts. The U.S. dollar is the currency used to express performance. Performance results include the reinvestment of all income. Pure gross returns do not reflect the deduction of any expenses, including trading costs. Prior to December 31, 2005, net annual returns are calculated by deducting 1/4th of an assumed maximum annual wrap fee of 3% on a quarterly basis. Beginning January 1, 2006, net annual returns are calculated using actual fees incurred. If no fee data is provided by wrap sponsors, the maximum annual wrap fee of 3% is used to calculate net of fee performance. Wrap fees include all charges for trading costs, portfolio management, custody, and other administrative expenses.

Internal dispersion is calculated using the asset-weighted standard deviation of annual gross returns for accounts in the composite for the entire year. For those years when less than five accounts were included for the full year, no dispersion measure is presented. The three-year annualized ex-post standard deviation of the composite is presented starting December 31, 2012 because prior to January 1, 2010, the composite return was calculated quarterly and 36 monthly returns are not available.

	3-Yr Annualized Standard Deviation (%)	
December 31	**Composite**	**Benchmark**
2012	15.37	20.48
2013	11.96	16.68
2014	9.77	13.31
2015	11.15	14.16

Year	Total Firm Assets ($ Millions)	Total Composite Assets ($ Millions)	Wrap Accounts as % of Composite Assets	Accounts at Year End	Pure Gross Annual Return (%)*	Net Annual Return (%)	Russell 2000® Annual Return (%)	Internal Dispersion
2006	6,523	1,011	100%	51	13.46	11.87	18.37	0.46
2007	5,392	847	100%	39	3.25	1.71	-1.57	0.21
2008	3,445	469	100%	49	-28.15	-29.36	-33.79	0.42
2009	4,010	565	100%	54	31.80	29.72	27.17	0.71
2010	4,729	659	100%	67	24.83	22.52	26.85	0.71
2011	5,232	846	100%	70	9.64	7.75	-4.18	0.51
2012	6,545	1,073	100%	71	13.75	11.80	16.35	0.31
2013	7,841	1,336	100%	67	30.89	28.76	38.82	0.45
2014	7,989	1,294	100%	70	7.31	5.57	4.89	0.27
2015	8,095	1,023	100%	55	2.09	0.51	-4.41	0.38

*Beginning October 1, 1995, pure gross returns are supplemental to net returns.

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RISK CONSIDERATIONS

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